

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001**

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

) Docket No. R2000-1
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INITIAL BRIEF

OF

**MAIL ORDER ASSOCIATION OF AMERICA,
DIRECT MARKETING ASSOCIATION, INC. AND
ASSOCIATION FOR POSTAL COMMERCE**

Due: September 13, 2000

#558819

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DOCKET NO. R2000-1

**STATEMENT OF THE CASE AND
STATEMENT OF POSITION**

The parties to this joint brief support the Postal Service's proposed piece and pound rate design for Standard Mail A Regular and ECR pieces entered above the 3.3 ounce break point.

DISCUSSION

I. Introduction.

The Postal Service has proposed modest reductions in the pound rates applicable for pieces weighing in excess of 3.3 ounces for the Regular and Enhanced Carrier Route (ECR) subclasses of Standard Mail A. For Regular the proposed decrease in the pound rate is from 67.7 to 66.1 cents per pound and for ECR from 66.3 cents to 58.4 cents per pound. Additionally, the per pound discounts for destination entry would be increased slightly from current levels for both subclasses. The overall revenues from pound-rated pieces would be increased under the proposed rates because of the increase in the per piece charge. Witness Moeller, USPS-T-35 at 22, 23. See witness Moeller, USPS-T-35 at 17, 28 for a summary of the proposed Regular and ECR rates.

In proposing the pound rate reductions, the Postal Service has recognized that the parcel surcharge “reduces the need for the pound rate to act as a proxy for the changing shape mix as weight increases.” *Id.* at 8. The Postal Service’s design to isolate shape from weight as a cost driver and to reflect those two cost drivers separately in the rate design is conceptually correct.

The Postal Service’s proposal relies upon a new cost study to determine the affect of weight upon Standard Mail A costs. Witness Daniel, USPS-T-28. The study responds to criticisms made by the PRC in Docket No. R97-1.

Competitors of the Postal Service are not concerned about the pound rate for Standard Mail A Regular; their concern is limited to the ECR subclass. The moderate reduction in the ECR pound rate was “designed to allay concerns for those that contend they may be disadvantaged by a significant reduction in the pound rate.” Witness Moeller, *Id.* at 23. If pound rates were to be based solely on costs, they would be considerably lower than proposed by the Postal Service.

In addition to the fact that witness Daniel’s cost study demonstrates that the current pound rates are too high, the current rate structure is irrational on its face. For nonletters mailed at the saturation level the current piece charge, 0.3 cents, is inconsequential. As a result, the rates for such mail nearly double as weight doubles. Thus, Postal Service revenues from a single eight-ounce piece are virtually identical to the revenues from two four-ounce pieces. That result defies common sense. Clearly, it does not cost twice as much to handle a particular piece of mail only because its weight

has doubled, particularly in the context of the Standard Mail A subclasses that are restricted to such a small range of weights. As observed in an understatement by witness Moeller "it seems illogical that the Postal Service would be that indifferent between processing and delivering two four-ounce pieces, and one eight-ounce piece." *Id.* at 21, 22.

Opponents of the proposed rates contend that USPS Witness Daniel's cost study does not provide reliable data about the relationship between Standard Mail A weights and costs. The evidence in the record, however, which includes both qualitative and statistical analyses, demonstrates that the study constitutes a valid and reliable basis for the proposed pound rates.

The newspapers and others engaged in alternative delivery also contend that the lower proposed pound rate is unfair because it might permit the Postal Service to compete more effectively for that portion of ECR mail that is entered at the saturation level. See testimony of Newspaper Association of America (NAA) witness Tye Tr. 30/14687 ff and Association of Alternate Postal Systems (AAPS) witness White Tr. 22/9935 ff. The claims of competitive harm, however, are based upon mere assertions rather than evidence.

The data that have been obtained in discovery demonstrate why no effort was undertaken by either NAA or AAPS to establish a factual basis for the claims of competitive harm. The record shows that competitive rates will continue to be

significantly lower than those proposed by the Postal Service and that competitors have enjoyed robust volume growth.

The Commission should not use the unsubstantiated claims of competitors to recommend Standard Mail A pound rates higher than proposed, rate levels that are higher than could possibly be supported on the basis of costs. To do so would violate the basic principle of cost-based rates. It would also damage those businesses that use Standard Mail A, users that range from the large to the very small.

II. The Proposed Pound Rates for Standard Mail A are Supported by Reliable Cost Data.

A. The Postal Service has Presented a Valid and Reliable Study That Amply Supports the Proposed Pound Rates.

USPS witness Sharon Daniel, USPS-T-28, has presented a cost study to demonstrate the effect of weight on the costs of Standard Mail A. The study is based principally upon the use of IOCS data. Despite suggestions that various engineering study approaches might be more appropriate, witness Daniels recognizes that the IOCS provides cost data “in all mail processing and carrier in-office operations around the clock, 24 hours per day, 7 days per week.” *Id.* at 4. As concluded by witness Daniel:

This system provides a much more extensive set of data derived from actual Postal Service operations than any one-time engineering or field study could provide.

Id. at 4.

Witness Daniel has been responsive to the concerns expressed by the PRC in Docket No. R97-1. Elemental load time costs were treated by witness Daniel as entirely weight-related. Although such costs might be somewhat weight-related, it is obvious that some portion of the costs are incurred independent of weight, i.e. are piece-related. Therefore this change inevitably serves to overstate to some extent the effect of weight upon costs. She also uses an improved methodology to distribute costs where weight is unknown by using the tallies within a cost pool, activity code or subclass where weight is known, rather than using aggregate costs. *Id.* at 5.

As will be shown in the discussion below, the testimony of those witnesses seeking to impeach witness Daniel's cost study has been effectively rebutted by a number of witnesses. The quantitative and qualitative testimony of the rebuttal witnesses demonstrates that adverse witnesses have failed to undermine the reliability of witness Daniel's study as a basis upon which to establish the pound rates for Standard Mail A.

No study or any attempt to analyze costs in any enterprise, let alone an enterprise as vast as the Postal Service, can ever escape criticism, particularly from parties whose interests are served by maintaining the current excessive pound rates. The role of the PRC in considering a Postal Service request must necessarily be to determine whether there is substantial evidence to support the Postal Service's proposal. The PRC should use the evidence in the record showing that the current pound rates are excessive. The proposed pound rates produce increases in rates that exceed the increases in

costs associated with increased weight, i.e. the maximum possible effect of weight upon costs is amply reflected in the proposed rates.

B. The Criticisms of Those Witnesses Attacking Witness Daniel's Cost Study Are Without Substance.

1. Introduction.

Witness John Haldi on behalf of Val-Pak, *et al*, Tr. 32/15751 ff, and witness William B. Tye on behalf of the Newspaper Association of America, Tr. 30/14698 ff, attempt to discredit the reliability of witness Daniel's study. Witnesses Haldi's and Tye's criticisms of witness Daniel's study will be addressed below. Initially, however, it should be noted that the essence of their testimony is the position that the Commission should ignore the cost data that has been presented and instead continue to set pound rates based upon no data whatsoever. That is not an acceptable approach to establishing rates. Cost data presented by the Postal Service may not be perfect, but using that data is certainly better than continuing to set the pound rates for Standard Mail A based on nothing at all.

2. Witnesses Prescott's and Bozzo's Statistical Analyses Validate the Reliability of Witness Daniel's Cost Study.

The criticisms made by witnesses Haldi and Tye of witness Daniel's study, including criticisms of the "thinness" of certain data are shown to be invalid by the regression analyses performed by MOAA et al. witness Roger C. Prescott. Tr. 44/19265 ff.

Witness Daniel used average weight per piece and average cost per piece as inputs into her regression model. *Id.* at 19279. Witness Prescott used an alternative approach to assess the criticisms raised by witnesses Haldi and Tye regarding the reliability of the cost data for determining the relationship of weight to costs. He calculated the average cost per pound instead of the average cost per piece and the average pieces per pound instead of the average weight per piece. He used these inputs in a regression model to determine a cost line reflective of the average cost per piece and average cost per pound. Regressions based on this data were calculated separately for both the Regular and ECR subclasses. *Id.* at 19280-81.

This alternative approach to analyzing the IOCS cost data demonstrates that there is a strong, reliable and consistent relationship between changes in weight and changes in cost for Standard Mail A. *Id.* at 19283-84. The regression analysis shows that both the current and proposed pounds are higher than needed to recover pound-related costs. It also shows that approximately 96 percent of the changes in the cost per pound for Regular and 97 percent for ECR are explained by changes in the pieces per pound (i.e., the weight function). See Prescott, Table 2. *Id.* at 19280.

Further, witness Prescott's regression shows that the pound costs for both Regular and ECR are significantly below the rates that have been proposed by the Postal Service. The weight related cost component of each regression equal 17.6¢ per pound for ECR and 52.5¢ for Regular. *Id.* at 19284. Prescott's analysis is persuasive evidence that the IOCS cost data reliably can be used to set pound rates and that the

proposed pound rates increase more rapidly with increases in weight than the change in costs associated with increases in weight.

Witness Prescott also rebuts witness Tye's attempt to use the sharp increase in costs at the 15-16 ounce interval to impeach witness Daniel's study. Witness Tye concludes that the interval, which shows sharply higher costs per piece, is better supported than the other intervals. Tr. 30/14701. He also disputes the possible reasons for the higher costs postulated by witness Daniels. *Id.* Regardless of the reasons for the higher costs, the important fact is that inclusion of the data for the 15-16 ounce interval negatively affects witness Daniel's regression analysis. *Id.* at 19294-95. In other words, the study would produce smaller variations both per piece and per pound, and a lower cost per pound, if the 15-16 ounce interval were removed. The better approach is to not eliminate the interval. As shown by witness Prescott's alternate analytic approach, there is no reason to eliminate or otherwise manipulate the data for particular weight intervals. *Id.* at 19295.

Witness Prescott analysis also shows that witness Haldi's (and Tye's) criticisms of witness Daniel's use of "thin" tallies and the methodology used to assign not handling tallies to the weight increments are misplaced. The statistical approach used by witness Prescott demonstrates that the "thinness" of tallies does not serve to invalidate the relationship of weight to costs. *Id.* at 19298.

USPS witness A. Thomas Bozzo's testimony, USPS-RT-18, Tr. 44/19460 ff, also shows that the criticisms of data "thinness" are not valid. He computes the coefficients

of variation for the zero to 3 and over 3 ounce weight increments for the Standard Mail A subclasses. With the exception of nonprofit ECR, the coefficients of variation are low, ranging from less than one percent to less than five percent. Thus, "the coefficient of variation shows that data 'thinness' is not a concern for the . . . Standard Mail (A) rate designs." *Id.* at 19474.

3. Witness Daniel Properly Allocated "Not Handling" and Mixed Mail Tallies.

Witness Haldi's criticisms of the USPS approach to the allocation of costs from not handling tallies is premised upon the assumption that all mail handling is done only at full capacity. There is generally excess capacity in bulk containers, however, and therefore the variability of costs with volume is considerably less than 100 percent. Costs do not increase in exact proportion to increases in weight. An increase in weight may actually result in the use of larger and therefore more efficient containers. Witness Crowder at Tr. 44/19294. Witness Prescott at Tr. 44/19299-00.

Additionally, witness Haldi's testimony depends upon the assumption that all not handling costs are driven by weight. Not handling tallies are frequently the result of performing tasks not related to weight. Therefore, the distribution of the costs of not handling tallies based on the distribution of mail handling tallies is an appropriate approach. If anything, it may well tend to overstate the effect of weight on those tallies. Witness Crowder at Tr. 44/19397-98.

Witness Bozzo, also effectively rebuts witness Haldi's criticisms. If a particular activity requires more labor time than some other activity, the activity requiring more labor time will result in more IOCS tallies than the other activity. If tubs being filled with heavier flats fill faster than those filled with lighter flats the result will be a greater number of tallies for the heavier pieces. Thus, the handling tallies provide a valid basis for assigning the cost of not handling tallies. Tr. 44/19466-67.

The Postal Service's methodology for assigning mixed-mail tallies is also correct. The Postal Service's methodology does "not distribute mixed-mail tallies from one type of handling activity on direct mail tallies from a completely different type of handling activity. . . ." *Id.* at 19467. As witness Bozzo explains, "[w]here mail handling from sorting operations enter the distribution keys, most notably in allied labor cost pools, they do so in recognition of the relationship between allied labor cost pools and the distribution operations they support. . . ." *Id.* at 19468. In summary, the methodology used by the Postal Service for mixed mail distribution "ensures that the mixed-mail tallies have the same relationship" as the proportion of direct tallies. *Id.* at 19468.

Witness Daniel's approach recognizes the differences in the composition of handling between direct and mixed mail tallies. USPS-T-28 at 4. As witness Bozzo observes, the method used "by witness Daniel constitutes a significant advance over witness McGrane's analysis from Docket No. R97-1, precisely because it is the first weight distribution method to recognize the differences in the composition of handlings between direct and mixed mail tallies. . . ." Tr. 44/19470 (footnote omitted). Further, it

seems probable that the use of direct handling tallies as a distribution key serves to overstate the effect of weight. *Id.* at 19394-95.

4. Other Criticism's of Witness Daniel's Study Are Not Valid.

Witness Haldi's use of what he terms "link relatives" to attempt to demonstrate that the Postal Service's cost allocation methodologies are faulty is without substance. Witness Haldi's analysis deals with letter cost estimates and the data does not show any "anomaly" until the four to five ounce range. As stated by witness Bozzo "the zero-4 ounce increments contain 99.8 percent of the Test Year ECR letter piece volume, and 99.4 percent of the volume-variable cost. . ." Tr. 44/19469. As he concludes, "a relatively high degree of sampling variation in the cost estimates for the remaining 0.2 percent slice of the ECR letter volume hardly invalidates the Postal Service's cost system as a whole." *Id.* at 19470.

Witness Daniel distributed route costs on the basis of pieces and load costs on the basis of weight. In so doing, she employed "the lower bound on the cost-weight relationship for the route costs and the upper bound for the load costs." Tr. 44/19478. This results in a conservative calculation of the relationship of weight to costs, i.e. the methodology tends to overstate the effect of weight on costs. As shown in witness Bozzo's Table 5, the implicit cost coverage for pound-rated ECR mail, using the lower bound costs, rather than witness Daniel's approach of using the upper bound method,

results in an implicit cost coverage of 248 or 250 percent depending upon whether a 3.0 ounce or 3.5 ounce dividing line is used. *Id.* at 19480.

5. Witness Crowder Has Performed a Number of Analyses That Demonstrate That The Criticisms of Witness Daniel's Cost Study Are Not Valid.

Witness Crowder performed a number of analyses that show that costs do not increase nearly as steeply as a result of weight increases as implied by the rates proposed by the Postal Service. She calculated the per pound costs that would result under the extreme assumption that all costs are purely weight-related, with no piece-related handling costs. She did this for all flats, and flats over the 3.3 ounce break point. The resulting pound rates are lower than proposed by the Postal Service. Tr. 44/19376.

She also performed regression analyses for flats entered at the basic level and flats entered at the high density and saturation levels. Those analyses showed pound costs of 22.2¢ for Basic and 16.5¢ for High Density and Saturation mail. *Id.* at 19378.

She performed an analysis that assumed that the entirety of the cost differences between letters and non-letters are due to the weight difference between letters and non-letters, i.e. an assumption that no cost differences are the result of shape differences. Even under that extreme assumption, the costs per pound are considerably smaller than the pound rates that have been proposed by the Postal Service. *Id.* at 19381-82. Further, under the Postal Service's proposed rates, ECR

nonletters will make a greater contribution to institutional costs than letters. This contribution will grow as weight increases, a relationship that holds true at both the Basic and Saturation levels. *Id.* at 19383.

Witness Crowder also points out that witness Haldi, recommending a rejection of the Postal Service's proposed pound rates in this proceeding, took an entirely different stand in his testimony in Docket No. R97-1. In that proceeding witness Haldi characterized the USPS proposal as "conservative." *Id.* at 19381. That characterization of pound rates as "conservative" was in reference to proposed pound rates that were considerably lower than proposed by the Postal Service in this proceeding.

6. Witness White's Anecdotal Observations on the Effect of Weight on Carrier Costs are Not Valid.

Witness White's contentions that weight has a large affect on city carrier walking time are wrong. Using his own example, it is clear that additional weight would have little if any impact on costs. Tr. 44/19396-97. There is ample excess capacity within postal satchels. Therefore, increased weight does not cause additional costs. The average weight of each park and loop satchel is 11.3 pounds, only about 1/3 of the 35-pound satchel limit. *Id.* at 19399. The average park and loop route would require the carrier to handle only 25 pounds of mail per loop, again far below the 35-pound limit. Because of excess capacity there is not a one-to-one relationship between increases in weight and increases in costs. *Id.* at 19397-98.

7. Summary and Conclusion.

The issue is not whether there is a precise fit between the rate and the weight-related costs of a particular piece of mail at a particular weight, but rather whether there is a reliable relationship between increases in weight and increases in cost, and a pound rate that will recover all pound-related costs. Witness Daniel's cost study provides valid data upon which to base the rate design and all pound related costs are more than recovered by the pound rates.

As concluded by witness Crowder, the use of IOCS data "captures the effect of all the diversity." Tr. 44/19393. Further "it would be exceptionally difficult (if not impossible) to identify system-wide, rate-category-specific, weight-related costs through an industrial engineering, modeling or some other non-IOCS-type approach." *Id.* at 19393. Witness Crowder is correct that insistence on these types of analyses is "essentially a guarantee that the obviously excessive pound rate will never be reduced." *Id.* at 19394.

Witness Haldi insists that the status quo should be maintained until the USPS has undertaken studies that would precisely measure the cost behavior of Standard Mail A separately on the basis of various methods of entry and other variables. Following his recommendations, of course, would doom any reform of an obviously excessive pound rate. Rates are being set for subclasses; not for the various types of entry and preparation. As concluded by witness Crowder, the pound rate "should represent the weight-cost relationship for the mix of volumes to which it applies." Tr. 44/19393. That

necessarily requires analysis of the Standard Mail A subclasses as a whole, as witness Daniel has done.

Obtaining the relationship of costs and weight in a fashion that would meet the criticisms of witnesses Haldi and Tye, is impossible as a practical matter,. Further, the criticism that have been made by witness Tye show “the fallacy of constructing an opinion and recommendation based on looking at the results for the least important volume in the outer weight-fringe of the subclass.” Tr. 44/19401. All of the nonletter volume above eight ounces represents only 1.4 percent of total ECR volume and volume in the 15-16 weight cell constitutes only .04 percent of ECR volume. *Id.* at 19401. Witness Tye’s attempt to demonstrate the unreliability of witness Daniel’s cost study focuses upon the extreme ends of that study and weight increments that account for only a small portion of the volume.

As witness Bozzo observes, “it is true, but irrelevant, that witness Daniel’s data do not clearly identify the precise effect of mail piece weight on cost in isolation from other factors.” Tr. 44/19481. All that is needed is to determine the cost of mail subject to the “piece and pound rates in the aggregate” and “the available cost data are sufficient” for that purpose. *Id.* at 19481. In sum, “the cost data needed to support the. . . pound rates need not satisfy the excessively stringent requirements suggested by witness Haldi.” *Id.* at 19482.

C. The Only Pound Rates Supported by Substantial Evidence of Record are Those That Have Been Proposed by the Postal Service.

As discussed above, USPS witness Daniel's cost study provides ample support for the Standard Mail A pound rates proposed by the Postal Service. The only challenge that reasonably could be made is that the rates are too high. The study shows that the actual effect of weight upon postal costs is far less than that implied by the proposed rates. What is clear is that there is no justification for a pound rate that is any higher than proposed by the Postal Service.

The substantial evidence requirement of 5 U.S.C. § 706 (2)(E) has been recognized by the courts as binding upon the Postal Rate Commission. As stated by the D.C. Circuit:

This court can uphold the PRC's Recommended Decision only if it is based on "such 'relevant evidence as a reasonable mind might accept as adequate to support [the] conclusion.'"

Mail Order Ass'n of America v. U.S. Postal Service, 2 F.3d 408, 420 (D.C. Cir. 1993). (citations omitted).

In *MOAA*, the D.C. Circuit struck down the PRC's recommended decision recommending a public automation rate (PAR) because "the record was devoid of any evidence to support the PRC's estimates of the volume or the automation acceptability" of the mail in question. *Id.* at 422. There is not only no substantial evidence of record to support the existing pound rates, there is in fact no evidence. In Docket No. R90-1, the Commission, in discussing Standard Mail A rates, found that "no cost study

underlies the pound rate, a fundamental component of rate design.” PRC Op. R90-1, App. K at 2. What was true at that time remains true: no cost study, or indeed any cost data, support the existing pound rates. The only pound rates before this Commission supported by evidence are those proposed by the Postal Service.

The provisions of 5 U.S.C. § 706 (2)(E) are clear. A reviewing court shall set aside agency findings found to be “unsupported by substantial evidence.” As then Judge Scalia writing for the D.C. Circuit found:

The distinctive function of paragraph (E) -- what it achieves that paragraph (A) does not -- is to require substantial evidence to be found *within the record of closed-record proceedings* to which it exclusively applies. The importance of that requirement should not be underestimated.

Ass’n of Data Processing v. Board of Governors, 745 F.2d 677, 684 (D.C. Cir. 1984). (emphasis by the court). Accord, *Mail Order Ass’n of America v. U.S. Postal Service*, 2 F.3d 408, 420 (D.C. Cir. 1993).

The issue, therefore, is not whether some other approach to determining the relationship of weight to costs within Standard Mail A could be undertaken. The fact is that no other approach is a part of the record. The Postal Service has presented a study that has not been impeached. The criticisms of those witnesses attacking witness Daniel’s study have been shown to be without substance. The cost study is premised upon the IOCS, the basic building block of postal costing. Witness Daniel has carefully used IOCS data in a way that avoids distortions when assessing the effect of weight upon costs. In sum, the Postal Service’s pound rate designs are well supported

by substantial evidence of record and, therefore, should be recommended by the Commission.

III. The Current Pound Rates are Having a Significant Negative Effect Upon Business Mail Users and Neither the Existing Nor Proposed Pound Rates Threaten Significant Negative Effects Upon Competitors.

A. Mailers Have Presented Substantial Evidence That The Existing Excessive Pound Rates Have Had a Significant Negative Effect Upon Their Businesses.

In assigning the institutional costs of the Postal Service, factor 4 requires the Commission to take into account the effect of postal rates upon "business mail users." In stark contrast to those parties seeking to defeat cost-based Standard Mail A pound rates, business mail users have presented substantial evidence that the current, excessive pound rates represent a distinct competitive disadvantage, precluding them from competing effectively with the newspapers and alternate delivery companies for a substantial portion of advertising materials.

The use of Standard Mail A to deliver advertising messages represents a major and vital part of the economic life of the country. Standard Mail A is used by businesses, both big and small, to promote their goods and services. Of equal importance, business mail, in the form of Standard Mail A, represents a vital part of the mail stream. The ability of the Postal Service to carry out its overall mission of binding the nation together would become much more difficult in the absence of strong and growing volumes of Standard Mail A.

One of the important characteristics of the ECR subclass at the high density and saturation levels is that it serves in substantial part the advertising needs of rather small businesses. Meeting the stringent requirements imposed upon saturation mail generally requires companies of a relatively large size, or those concentrating upon a limited geographic market. Most Saturation and High Density mail comes from shared mail or TMC sources. The availability of shared mail is of great importance to businesses of small to modest size. In the absence of shared mail, it would not be economical for many advertisers to make use of the mail.

As stated by witness Harry J. Buckel on behalf of the Saturation Mail Coalition, small businesses have few alternatives in terms of reaching their customers. Indeed, "geographically targeted saturation mail may be the only cost effective choice." Tr. 22/9908. The great preponderance of the advertising messages carried by the members of the Saturation Mail Coalition are sent by local retailers, small service businesses and individual entrepreneurs. Nevertheless, the viability of this shared mail industry "depends on the extent to which we can compete for retail advertising preprints of the medium to large store customer." Id. at 9914. The costs of using the mail, resulting from the high pound rate, is leading to a loss of market share, particularly in major metropolitan areas. Id. at 9915. The reduction of the pound rates proposed by the Postal Service "will help shared mailers retain some of the business we need from medium to large customers" in order to be able to continue to use the Postal Service for the delivery of advertising messages. Id. at 9916-17.

Intervenor testimony has demonstrated the importance of the pound rate from a number of differing perspectives. Saturation Mail Coalition witness Roger Merriman, Tr. 32/15656 ff, testified on behalf of an advertising publication targeted to rural audiences. As he states, “to reach agrarian households and businesses in our market area, the USPS is the only game in town.” Tr. 32/15658-59. Witness Merriman, therefore, speaks not for those business mailers threatened by a loss of business to competitors by the continuation of the excessive pound rates, but rather the importance of being able to reach a rural community that is not attractive to Postal Service competitors. The proposed pound rates would serve to benefit not only his company, and the advertisers and consumers served, but also the USPS. It would help increase pound rate revenues. *Id.* at 15659.

The only option available to advertising publishers for rural areas in the face of unreasonable rates, particularly pound rates, is to reduce circulation and, to the extent possible, raise prices. *Id.* at 15663. Unlike the Postal Service, competitors set their rates without significant regard to weight. Under the proposed pound rates there would still be substantial disparities between the Postal Service and private carriers and the “weight-insensitive rates they charge to advertisers,” but the proposed modest reduction would “help our advertisers.” *Id.* at 15666. The excessive pound rates have also prevented publications from offering information that is of general value to the community and offering free promotional space to charitable organizations. *Id.* at

15667. As he concludes, the high pound rates make “our task of linking advertisers and farm families together more difficult.” *Id.* at 15668.

Witness Buckel’s testimony shows the importance of pound rates lower than the current excessive levels to advertising publications serving urban areas. Here the threat is similar to the threat faced by those meeting the advertising needs of a rural market. They are more severely challenged, however, because urban mailing customers have options available, newspapers and other private alternatives. The current high pound rates makes it difficult, if not impossible, for them to offer effective competition.

We do not argue that there should be a goal of establishing postal rates at a level that would preclude alternate delivery of advertising materials. At the same time, the clear terms of factor 4 of the Act require that postal prices recognize the effect of those prices upon “business mail users.” Clearly, current Standard Mail A pound rates fail to meet that requirement. The current rates threaten a continuing loss of larger advertisers with “more alternatives when it comes to mass media methods to reach consumers.” Tr. 22/9911. The inability to attract those large advertisers threatens the ability of the providers of shared mail to offer reasonable prices that are within the range of smaller business including individual entrepreneurs.

Alliance of Independent Store Owners and Professionals (AISOP), witness Richard Smith, Tr. 30/14528 ff, illustrates the importance of the pound rate to a small merchant. Witness Smith is the owner of a grocery store that depends upon “free papers sent by

saturation mail." Tr. 30/14529. Most of the advertising for his business is done through a shopper publication mailed at saturation rates by the Postal Service. As he explains, small businesses can compete with larger stores on the basis of prices and service but they are at a serious "disadvantage in competing with the majors" in terms of advertising choices and the costs of reaching consumers in a small market area. *Id.* at 14535.

ALSOP witness Orlando Baro, Tr. 30/14369 ff, testified about the importance of saturation mail rates, and in particular the pound rate, for free newspapers. The use of such papers is particularly vital to the smaller businesses making use of the paper as a means of delivering advertising messages. The viability of free newspapers is important not only to provide a means of delivering advertising messages at a reasonable cost, but also because they provide an important value to the community. Free newspapers are valuable to their communities not only by offering a cost effective means of delivering advertising messages, but also because of the general importance of such publications to the community as a whole, such as contributing free space to annual community events. Tr. 30/14380.

B. Those Parties Alleging Competitive Harm if the Pound Rates Proposed by the Postal Service Were to be Adopted Have Failed to Present Testimony Substantiating Those Claims.

Both Newspaper Association of America witness William Tye, NAA-T-1, Tr. 30/14687 ff, and Association of Alternate Postal Systems witness John White, AAPS-T-1, Tr. 22/9935ff, maintain that the Standard Mail A pound rates proposed by the Postal Service will cause competitive harm and invoke the provisions of factor 4 to argue that the pound rates should be increased.

AAPS would appear to be a substantial association. It claims membership of approximately 110 companies, a number of which are owned and operated by newspapers and publishers of shopping guides. Tr. 22/9942. The NAA represents all of the major newspapers in this country, with many billions of dollars in revenues. Both are represented by well-experienced counsel. Thus, there can be no excuse for those Associations presenting testimony claiming competitive harm, while at the same time failing to produce a single shred of evidence substantiating the existence of any harm that might result from adoption of the Postal Service's proposed pound rates.

Witness Tye expressed his view that there should not be a "price below the market" with respect to mail rates. Tr. 30/14988, but conceded; "I don't have the rates that the newspapers charge." Tr. 30/14993. That being the case, it is clear that witness Tye's testimony is nothing more than a theoretical exercise in which he is counseling the Commission to establish extremely high cost coverages and high prices for Standard

Mail ECR even though he has no market knowledge of the very entities for whom he is testifying i.e. the newspapers. Under these circumstances, witness Tye's testimony is entitled to no weight.

1. The Commission Should Invoke the Adverse Inference Rule.

The Commission, faced with the failure of either of association to produce any evidence of significant competitive harm that would occur from the proposed rates, should adopt the adverse inference that the evidence would not show any such adverse effects. Briefly and simply stated, "the rule provides that when a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him." *International Union (UAW) v. N.L.R.B.*, 459 F.2d 1329, 1336 (D.C. Cir. 1972). The court describes the adverse inference rule as "more a product of common sense than of the common law." *Id.* At 1335.

Witness White conceded that the rates charged by members of AAPS and the effect of weight upon those rates were relevant to the Commission's evaluation of his testimony, but presented no testimony about those rates. Tr. 22/9992. Similarly, NAA witness Tye conceded that he neither requested nor received information concerning the rates charged by newspapers for free standing inserts or the effect of weight upon those rates. He also conceded that such rates were relevant to applying the pricing criteria of the Postal Reorganization Act. Tr. 30/14781. Despite those concessions, he

had no estimate of revenue and volume growth for newspaper activity in competition with Standard Mail A ECR. Tr. 30/14846.

There could hardly be a clearer case for the application of the adverse inference rule. Here we have parties that clearly have the resources, and access to the facts, to substantiate any claim of an adverse competitive effect upon their members as a result of the rates that have been proposed by the Postal Service. Their failure to substantiate their claims should lead this Commission to evaluate the Postal Service's pricing proposals strictly on the basis of the cost data presented by the Postal Service, and the effect of the rates on business mail users. To do otherwise would reward what can only be characterized as a deliberate decision by the Associations to avoid placing admittedly relevant data before the Commission upon which their claims of adverse effect could be evaluated.

USPS witness Donald J. O'Hara, USPS-RT-19, testified, that the "unexplained and glaring omission [to present competitive data] seriously undermines the credibility of their conclusions." *Id.* at 8. He is much too kind. Although obviously he is correct that the failure to submit such data undermines their credibility, it does much more. By the application of the adverse inference rule, the Commission should conclude that there would be no competitive injury resulting from adoption of the USPS proposed rates. This conclusion is strengthened by the fact that those witnesses supporting the Postal Service proposal have presented substantial evidence to support their claims that the existing pound rates leave them, and the customers they serve, at a substantial

competitive disadvantage because of the lower rates offered by the newspapers and other alternative delivery enterprises.

2. The facts obtained through discovery show that competitors would not be harmed by adoption of the proposed postal rates.

The data obtained through discovery demonstrate that claims of competitive harm by AAPS and NAA are without basis. In contrast to the unsupported claims of the Associations, the facts show that the proposed pound rates will not result in competitive harm, strengthening the conclusion that the Associations have deliberately decided not to introduce their own revenue, profit and pricing data.

The data provided by witness White for Distribution Systems of Oklahoma (DSO) show a healthy rate of growth from a total of 11.5 million pieces in 1995 to 15.9 million pieces in 1999, most of which are multiple piece TMC products. Tr. 22/9990. Additionally, his testimony demonstrates that he is well able to compete with the proposed rates of the Postal Service not only on the basis of the highest DSO "rate card" rates, but also because those rates are reduced for larger quantities, and even those low rates are subject to negotiation. Further, there is no increase in DSO rates up to the level of five ounces, i.e. weight plays no role in the rates charged for what is presumably a substantial part of DSO's business. Tr. 22/9990.

As correctly concluded by witness O'Hara "the price data for alternative media in this docket. . . indicate that the published prices of alternative media are generally

below the Postal Service's proposed prices, and this does not even consider the negotiated discounts that they may offer to their customers." USPS-RT-19 at 8. As he also observes "there is absolutely no showing that the industry's prices are anywhere near or above those of the Postal Service's proposed rates." *Id.* at 8, 9.

The preprint insert volumes carried by newspapers also shows a steady increase for the years 1982 through 1997. Indeed, volumes have tripled during that period. Exhibit USPS-RT-19A. The NAA has refused to produce any data for 1998 or 1999. We do know, however, that the advertising revenues of newspapers have shown a steady increase, and that as of 1999 totaled over \$45 billion. Exhibit USPS-RT-19B. See also Exhibit USPS-RT-19C. As concluded by witness O'Hara, the steady gain in advertising revenues by the newspapers "suggest that the newspaper industry is hardly suffering negative consequences from what witness Tye characterizes as a 'pronounced' inflation-adjusted decline in the ECR pound rate." O'Hara USPS-RT-19 at 9.

As discussed above, the data show that newspaper preprint volumes through 1997 have continued to grow. Witness Tye's claim that witness Tolley's testimony demonstrates a shift in volume from the private sector to ECR is simply unsupported. Tr. 30/14735. There is no evidence to indicate that any gain in ECR volume has come at the expense of competitors. Such evidence as we have indicates that that is not the case. As stated by witness O'Hara advertisers "do not necessarily perceive ECR and

newspapers or alternative delivery as direct substitutes, since they offer different features and are connected with different forms of valuable content.” USPS-RT-19 at 9.

Witness O’Hara also makes the important point that at the basic ECR tier, for which as few as ten pieces per carrier route will meet qualification requirements, there will be no effect on competitors since they do not offer the needed selective distribution. Clearly, a decline in the pound rate, in so far as it affects the basic tier, which accounts for approximately 50 percent of the totality of ECR, would not come at the expense of competitors. *Id.* at 9-10.

3. The testimony of other witnesses undercuts the claims of competitive harm.

The rebuttal testimony of witness Vincent Giuliano, SMC-RT-2, Tr. 18985ff, also shows that the unsubstantiated claims of AAPS and the NAA have no basis in fact. The competition of their members with the Postal Service for the delivery of saturation mail is strong and growing. As he concludes, “shared mail today is less competitive with newspapers and private delivery for the distribution of traditional multi-page preprints than it was in the mid-1980’s.” *Id.* at 18995. The fact is that mail, including shared mail “is less competitive today than it was in 1994, in large measure due to the pound rate.” *Id.* at 18995. Contrary to witness Tye’s claims that newspapers have suffered a diversion of preprint volumes, a claim unsubstantiated by any marketplace data, the facts are quite to the contrary. Advo’s share of preprints weighing more than an ounce has declined because of the excessive pound rate. *Id.* at 18995.

Witness Giuliano's testimony provides a specific example of how Advo was unable to compete in the Oklahoma City market, the city where AAPS witness White runs his alternative distribution business. He shows that the combination of the newspaper, *The Daily Oklahoman*, and its wholly owned subsidiary, Distribution Services of Oklahoma, has so dominated the Oklahoma City market that entry by private entities using the Postal Service has been precluded. *Id.* at 18996-97.

Witness Giuliano summarizes the advantages that private delivery has over the Postal Service mainly because of much simpler preparation requirements. This fact, together with excessive pound rates, has led Advo to enter the private delivery market, where it can accomplish delivery to the consumer at less cost than by delivery through the Postal Service. *Id.* at 13-17. The Postal Service's current rates are excessive and are forcing volumes out of the Postal Service artificially because not based upon costs.

The testimony of Association for Postal Commerce witness S. Scott Harding, Tr. 45/19580ff, confirms that the proposed Standard Mail A pound rates do not pose a significant threat to newspaper preprint volumes. Witness Harding, who acts as a broker and seeks to obtain the best prices for his clients from the Postal Service and the newspapers, flatly contradicts witness Tye's claim that there has been a significant shift in advertising from newspapers to Standard Mail ECR. In carrying out his responsibilities to his clients, witness Harding considers all distribution options, newspapers inserts, newspaper TMC products, alternate distribution carriers and enterprises using the mail. The use of these options has "remained relatively stable

over the past five years.” *Id.* at 19584. He specifically testifies, that “heavier and larger preprints” typically are distributed by newspapers. *Id.* at 19585. Accordingly, he supports the lower pounds rates because “any action to reduce costs will give far reaching benefits to all consumers.” The proposed lower pound rates, would “offer our clients affordable, efficient print media options.” *Id.* at 19586. As he concludes, it will “make the ‘playing field’ more competitive.” *Id.* at 19586.

Saturation Mail Coalition witness Bernard Bradpiece, SMC-RT-1, Tr. 44/18908ff, also offers persuasive testimony that rebuts the assertion that the Postal Service’s proposed pound rates threaten harm to competitors. His testimony shows that costs for private carrier delivery are significantly less than those for delivery through the Postal Service under both the existing and proposed rates. An 11 ounce piece under the proposed postal rates would still cost well over three times the cost of private delivery of that same piece. As he concludes: “under the rates proposed by the USPS, my postal cost of distribution will still be two to three times higher than my competitors.” *Id.* at 18915. For this reason he states: “It is no wonder that USPS competitors refuse to share their costs with this regulatory body.” *Id.* at 18915.

Witness Bradpiece establishes that neither the existing nor proposed rates will enable his pennysaver group to compete with the newspapers TMC programs. The ability of the newspapers to “set insert prices for advertisers by averaging their lower cost of subscriber delivery in the paper with the higher cost of mail will continue to allow them to set prices for inserts that I cannot match in any 100% mailed shopper.” *Id.* at

18920. The USPS proposal, however, will assist the ability of his business to retain display advertisers and meet the needs of smaller businesses that rely on the low cost ads offered by his pennysaver group. *Id.* at 18918. The Postal Service faces a distinct threat of volume losses despite his preference to remain with a mailed program. *Id.* at 18920-21. As he concludes “heavier papers or shared mail pieces, and those in densely populated metropolitan areas” are vulnerable to diversion from the Postal Service to private delivery. *Id.* at 18921.

4. Summary.

In general summary, the record shows the following:

- The representatives of alternate delivery, including the newspapers, have failed to provide data that would show that the rates proposed by the Postal Service represent a significant threat and have also failed to provide any data about how they price their products, particularly with respect to the influence of weight upon prices. For this reason alone, the Commission should draw the adverse inference that the data within their control would be contrary to their stated positions and would show that neither the current nor the proposed pound rates offer a significant competitive threat.
- The above conclusion is strengthened by such data as has been produced by NAA and AAPS through discovery. This data shows that the volume growth of the newspapers and alternative delivery companies continues to be robust

and that the rates charged for such alternate delivery are considerably lower than existing or proposed USPS rates.

- The testimony of other witnesses shows that neither the current nor proposed pound rates pose a significant threat to alternative delivery by the newspapers or other enterprises. The current nor proposed pound rates are a threat to business mail users and the customers and communities that they serve.

IV. Competitive Realities Support the Adoption of the Proposed Pound Rate.

A. The Commission's Objective in the Establishment of Postal Rates For Those Types of Mail Subject to Competition Should be to Preserve And Protect Competition; Not Competitors.

1. The Governing Principle.

This Commission has looked to the interpretation of the antitrust laws in carrying out its obligations under the Postal Reorganization Act to recommend rates for mail subject to competition. One of the most basic tenants of the antitrust laws is that their purpose is to protect "competition" not competitors.

To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result. . .

Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 116 (1986). See also

Matsushita Electric Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986).

But cutting prices in order to increase business often is the very essence of competition. Thus, mistaken inferences in cases such as this are especially costly, because they chill the very conduct the antitrust laws are designed to protect.

The Supreme Court's approach was recognized by the Commission as applicable to rate setting under the Postal Reorganization Act in its decision in Docket No. MC2000-2.

Competition, either direct or indirect, can be beneficial to the marketplace. To this extent, antitrust laws are designed to foster fair competition. They should not be applied to protect individual competitors. Businesses that experience competition will become more efficient and evolve with changing business conditions to offer new and improved products to the marketplace. The consumer also benefits from the variety of products offered and the efficient pricing caused by competition. The current pound rates, and indeed the rates for Standard Mail A as a whole certainly do not reflect "efficient pricing."

PRC Op. Doc. No. MC2000-2 at 33.

The District of Columbia Circuit has recently endorsed an approach to the rate making criteria of the Act that strongly supports the proposed reduction in the pound rates.

As to section 3622 (b)(5), the Commission has consistently, and reasonably, held that it authorizes a reduction in rates to maintain the position of the Postal Service as a competitor in the mail delivery industry.

United Parcel, Inc. v. U.S. Postal Service, 184 F.3d 826, 845 (D.C. Cir. 1999).

In this proceeding, the Postal Service is not even proposing to reduce rates. The rates for the Standard Mail A subclasses are increased under the proposal. The Service merely seeks to redesign its rates in order to move in the direction of cost based rates.

The Commission should apply the “competition” principle as enunciated by the Supreme Court, and its own decisions, in assessing the proposed pound rates. The Postal Service should not be prevented from altering its rate design if the changes are cost-justified and would serve to make the Postal Service better able to meet the competition. Without that approach, it is inevitable that the Postal Service will be weakened in the marketplace, a result that would harm all users.

2. The Commission’s MC2000-2 Decision.

The Commissions decision in Docket No. MC2000-2, and the Dissenting Opinion Commissioner Goldway, support a Commission decision recommending the proposed pound rates. Commissioner Goldway has well-summarized the courts’ treatment of “competition” issues And her Opinion has particular relevance to the issue of the proposed pound rates. The Majority’s “Separate Opinion,” issued “to identify and clarify the limited areas of disagreement between us” does not indicate a basic disagreement

with her views, as those views should be applied to the establishment of the pound rates. PRC Op. MC2000-2, Separate Opinion at 1.

The Majority's views on its role in recommending markups, cost attribution and rates, as expressed in the Separate Opinion, should not affect the Commission's decision about the proposed pound rates. Similarly, the issue of what types of costs should or should not be recovered in an experimental service is not applicable. The nature of the service also is not an issue. Regardless of how the Mailing Online service is characterized, the issue before the Commission with respect to Standard Mail A pound rates concerns strictly advertising mail that does not receive premium service. There is also no issue about the volumes of mail that will be subject to the pound rate. Obviously, there is never total precision in projecting volumes, but there is not the kind of uncertainty that arises in the case of a new service.

Ultimately, the most important part of the Separate Opinion, as it applies to the current proceeding, is the Majority's conclusion that the fee levels recommended will neither "impede the Service's entry into the hybrid mail arena, or have a significant impact on the success of this experiment." *Id.* at 4. In this proceeding, continuing Postal Service success requires approval of the proposed pound rates.

B. It is Important That the Postal Service Not Be Stymied In Its Effort to Offer Competitive Rates in Those Areas, Such as Standard Mail A, Subject to Diversion to Alternative Means of Delivery.

The Postal Service has suffered, and will continue to suffer, a significant diversion of volumes to electronic media, particularly for mail that would otherwise have been carried as First-Class mail. Further, the diversion which the Postal Service has suffered cannot be recaptured or prevented through changes in Postal prices. The speed and low cost of electronic alternatives are beyond the reach of hard copy delivery by the Postal Service. If current trends continue, the financial well being of the Postal Service is likely increasingly to depend upon its ability to attract growing volumes of Standard Mail, particularly mail being carried in the Standard Mail ECR subclass. Much of this mail is subject to vigorous competition from the newspapers and from other alternative means of delivery.

Any loss of First-Class business mail inevitably will require that greater portions of the institutional burdens of the Postal Service be borne by other types of mail. Unless the Postal Service can continue to attract growing volumes of Standard Mail A, all postal rates will be subject to substantial increases. Given the price sensitivity of Standard Mail A, particularly the mail carried within the Standard Mail A ECR subclass, it would be counterproductive to price this mail at a level that will, at best, inhibit growth.

Pertinent to this issue is the growth of e-commerce. Numerous companies are now attempting to sell goods and services via the internet without using the Postal Service

as a means of building or reaching a customer base. Further, virtually every business of any kind that currently relies primarily upon the mail to deliver its advertising messages, such as catalog companies, are experimenting with the use of the internet. The extent to which the use of the internet and e-commerce in general will affect the growth of Standard Mail, is not yet known. Nevertheless, it would be foolish for either the Postal Service or the Commission to ignore the fact that a potential threat exists. In particular, it would be most unwise to depart from the principle of cost-based rate making. To continue pound rates for price sensitive advertising mail at levels far above the cost of handling that mail does not make sense and poses a distinct threat to the ability of the Postal Service to carry out its mission.

C. The Current Pound Rates Threaten a Diversion of Mail Volumes to Private Delivery.

The existing high ECR rates, and in particular the high pound rates, have led and will continue to lead to a diversion of mail volumes from the Postal Service to private delivery. Since 1994 Advo has increased private delivery to the point that it currently delivers more than 120 million pieces annually. Tr. 44/19002. As witness Giuliano notes, witness White's company, DSO, touts the advantage of its delivery services over those of the Post Office, including the absence of a requirement for address labels and other cost saving advantages of private delivery including lower delivery charges. Witness Giuliano expands upon these advantages of private delivery including only minimal preparation requirements, no cost of transporting to postal drop ship points, the

elimination of other mail preparation steps and total control over delivery dates including Sunday. Witness Giuliano at Tr. 44/18998-99. Further, even at the pound rates that have been proposed by the Postal Service, the cost of postal delivery would still be considerably more than the cost of private delivery.

We do not argue that the Postal Service does not offer certain advantages over private delivery. It would appear that there is a greater prestige attached to delivery by the Postal Service. The Postal Service can compete provided that its prices are not too drastically out of line with those that are being offered in the private sector. Clearly, however, the current pound rates represent a serious threat to the ability of the Postal Service to continue to be able to attract a reasonable portion of the market.

The advantages that the Postal Service offers are acknowledged by witness Giuliano. *Id.* at 19003-04. He testifies that “Advo would much prefer to focus its efforts and energies on its traditional advertising marketing and mailing business, rather than entering the delivery business.” *Id.* at 19004. Nevertheless, a continuation of uneconomical and unjustified postal rates will inevitably lead to the growth of private delivery and the concurrent weakening of the Postal Service. The pound rate “is not only not cost-based, but has the effect of turning the USPS’s best customers into competitors.” *Id.* at 19005.

D. Significant Alternative Delivery Competition For ECR Mail Exists Only For The Saturation Level.

Alternative delivery competes only for mail entered at the Saturation and High Density levels, which comprises less than 50 percent of the mail within Standard Mail A ECR. Tr. 4/1219. For mail entered at the Basic level, which requires a density of only 10 pieces per carrier route, alternative delivery does not provide any competition. Tr. 30/15002. As concluded by witness O'Hara, any increase in volume in the Basic ECR tier would not "come at the expense of the alternate delivery or newspapers, who do not offer such selective distribution." USPS-RT-19 at 10. This is despite the fact that mail entered at the Basic level pays considerably higher postage rates than mail entered at the saturation or high density levels.

The fact that a substantial portion of the Standard Mail A ECR subclass has no reasonably-priced delivery alternatives available should not be ignored by this Commission in establishing the pound rates. For those parts of the ECR subclass for which no competition is available, the establishment of the pound rate at a level which is at least closer to costs associated with increasing weight is a matter of basic fairness and compliance with the overall requirements of the Postal Reorganization Act.

Additionally, the fact that there is no alternative means of sending many types of Standard Mail, such as Standard Mail catalogs and other selective delivery mail, does not mean that such mail is not highly demand sensitive. The catalog industry, for

instance, operates within a highly competitive market. Catalogs may not be subject to diversion to alternative delivery, but catalog volumes certainly are subject to decline because of rates that make it unprofitable to mail them. Higher rates cause catalog mailers to reduce the number and size of catalogs.

PROPOSED FINDINGS AND CONCLUSIONS

On the basis of the evidence and authorities discussed in this brief, the Commission should find that substantial evidence of record and the criteria of the Act support the rate design proposed by the Postal Service for the Standard Mail A Regular and ECR subclasses. Therefore, that rate design should be adopted in the Commission's Recommended Decision.



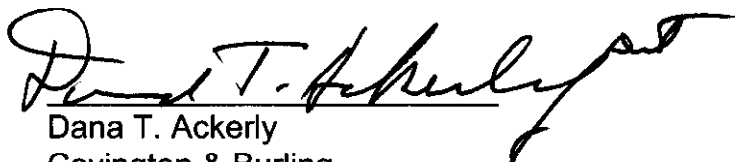
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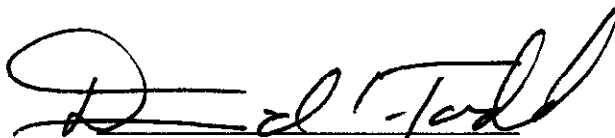


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CERTIFICATE OF SERVICE

I hereby certify that I have caused this Brief to be served upon all participants in this proceeding in accordance with Section 12 of the rules of practice this twelfth day of September, 2000.



David C. Todd

Due: September 12, 2000